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Memorandum for:

The attached Memorandum was prepared [redacted]
[redacted] in response to a request by
Roger Robinson of the NSC Staff.

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25X1

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E U R A

**Office of European Analysis
Directorate of Intelligence**

16 October 1984

MEMORANDUM

Foundations of Cypriot Economic Progress

Greek Cyprus has made remarkable economic progress since the war in 1974. The chaos resulting from the Turkish invasion that year turned half of the population of about 600,000 into refugees, while investment and production dropped precipitously. By 1983, most of these difficulties had been overcome. Inflation at the end of the year was just 6 percent and unemployment was only 3.5 percent. Foreign exchange reserves amounted to about \$514 million and were increasing at a steady rate. Despite some persistent problems, such as a stagnating industrial sector and expanding debt, most economists are optimistic about future prospects, expecting continued strong performance by tourism and exports and a decline in consumer imports. In addition, unemployment and inflation have fallen further of late -- the latter to just 3.7 percent during the first quarter of 1984. []

25X1

Geographical and cultural factors help explain the economic resurgence. Cyprus is strategically located near three continents, and the Greek population has a tradition of entrepreneurial skill and craftsmanship. Despite tensions over the division of the island, the Greek sector is politically stable and democratic -- features in stark contrast to trends in neighboring countries. Cyprus in particular has benefited from the crisis in Lebanon, which has frightened away many businesses and investors from Beirut, the former banking and commercial center of the Middle East. []

25X1

The Cypriot government, in conjunction with businessmen, has worked hard to attract Middle Eastern investors by encouraging exports of goods and services to the Arab world. Shipping, banking, and exports of foodstuffs and light manufacturing goods have been most lucrative. Since 1976, the country's trade and services accounts with the Middle Eastern countries have been in surplus, despite the increasing costs of oil imports. Building on its strong links to the EC, Cyprus also has invested heavily in tourist and conference facilities, and its telecommunications system is highly advanced by world standards. []

25X1

The specific steps the government has taken include:

- Quick processing of applications for foreign investment in domestic industry and "off-shore" enterprises.
- Tax allowances on investments in plant and machinery (30 percent) and the construction of hotel (25 percent) and industrial buildings (20 percent).

EUR M84-10211

25X1

25X1

- Tax allowances on mining investment and expenditures on scientific research.
- A maximum tax of only 4.25 percent on all taxable income derived from sources outside Cyprus.
- Reduced income tax rates for foreign employees.
- Tax-free remission of profits, interest, and dividends up to \$3,800. Sums above that level are taxed at a flat rate of 5 percent.
- The elimination of import duties on plant and machinery.
- The absence of any withholding tax on dividends paid by offshore firms. [REDACTED]

25X1

From 1973 to 1982, the government approved 5,500 requests by non-residents to establish companies or participate in joint ventures. Twenty-five hundred companies set up offshore operations in Cyprus in 1983 alone.

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25X1

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25X1

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Next 2 Page(s) In Document Denied